

Management's Discussion and Analysis

This analysis, prepared by the Office of the Comptroller, offers readers of the Commonwealth's financial statements a narrative overview of the activities of the Commonwealth for the fiscal year ended June 30, 2002. We encourage readers to consider this information in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the Commonwealth's financial statements, which follow. Unlike the letter of transmittal, this analysis is required by the Governmental Accounting Standards Board, (GASB,) which provides preparers with guidelines on what must be included and excluded from this analysis. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Because the Commonwealth is implementing new reporting standards for fiscal 2002, resulting in significant changes in content and structure, much of the information is not comparable to prior years. However, in future years, comparisons will be more meaningful and will go farther towards explaining the Commonwealth's financial position and results of operations.

Financial Highlights – Primary Commonwealth Government

Government – Wide Highlights

- ♦ **Net Assets** – The liabilities of the Commonwealth exceeded its assets at the end of fiscal 2002 by nearly \$4.4 billion. Of this amount, “unrestricted net assets” is reported as a negative \$15.5 billion. The primary reason for this is that the Commonwealth is incurring long term obligations to either construct or assist political subdivisions in constructing assets owned by these political subdivisions. For example, upon completion the Central Artery / Third Harbor Tunnel will be owned by the Massachusetts Turnpike Authority and the Massachusetts Port Authority. The Commonwealth is currently constructing these assets and significant debt is being incurred in that process. There are also large restricted net asset balances set aside for capital projects, unemployment benefits and debt retirement. Unrestricted net assets represent the amount available to be used to meet the Commonwealth's ongoing obligations to its citizens and creditors.
- **Changes in Net Assets** – The Commonwealth's net assets decreased by over \$3.7 billion in fiscal 2002. Net assets of governmental activities decreased by over \$3.0 billion. This decrease in net assets is primarily attributable to the Commonwealth spending down its reserves and the sudden decline in tax revenues. For the fiscal year, the Commonwealth's tax revenues dropped \$2.4 billion below prior year collections. Net assets of the business – type activities showed a decrease of nearly \$739 million. Expenses of governmental activities were nearly \$30 billion, while general revenue (taxes, investment income and tobacco settlement income) from governmental activities was slightly over \$13.3 billion.
- ♦ **Governmental Funds – Fund Balances** – As of the close of fiscal year 2002, the Commonwealth's governmental funds reported a combined ending fund balance of nearly \$2.5 billion. Of the \$2.5 billion:

Fund Highlights

Reserves Used to Balance the Budget
(Amounts in Thousands)

	FY02	FY03 (as budgeted)
Stabilization.....	\$ 1,030,000	\$ 550,000
Transitional Escrow.....	422,000	-
Health Care Security Trust	60,000	-
Caseload Mitigation	56,000	75,000
Medical Security Trust	35,000	-
Tax Reduction	33,605	-
MBTA Infrastructure Renovation	24,000	-
Massachusetts Clean Elections	-	20,164
Ratepayer Parity Trust	-	31,793
Operating Surpluses Transferred from Capital Projects	176,174	-
Total Completed and Estimated		
Budgetary Transfers	\$ 1,836,779	\$ 676,957

Budget – Funded Workforce
(Full – Time Equivalents)

	Governor's Authority	Judiciary	Other
1998	54,939	7,309	4,766
1999	56,295	7,829	6,403
2000	57,029	8,013	7,171
2001	58,030	8,204	7,421
2002	53,257	7,379	7,119

Source: Executive Office for
Administration and Finance

- \$226 million, net deficit, represents the “unreserved and undesignated fund balances” largely due to a \$1.1 billion deficit in the local aid fund and a nearly \$540 million deficit in the highway capital projects fund due to the timing of bond sales. The unreserved general fund balance of over \$1.4 billion offsets these deficits.
- Governmental reserves total nearly \$2.7 billion. They include \$86 million for continuing appropriations, \$881 million for stabilization, \$1 billion reserve in bond proceeds reserved for capital projects, largely connected with the Central Artery / Tunnel (CA/T) project and \$351 million reserved for retirement of indebtedness. During the year, the reserve for stabilization saw a dramatic decline due to measures passed to balance the budget. Other reserves that were used in this fashion are depicted at the left.

The unreserved and undesignated deficit balance of nearly \$226 million is roughly 0.7% of the \$30 billion of governmental fund expenditures for 2002.

To meet the fiscal challenges of fiscal 2002 and beyond, the Commonwealth took a series of measures to remain in fiscal balance.

- ◆ The Commonwealth transferred over \$1 billion out of stabilization during fiscal 2002 including \$442 million transitioned from fiscal 2001. An additional \$550 million will be transferred from stabilization in fiscal 2003.
- ◆ Over \$176 million in operating surplus previously set aside to fund capital projects was removed from capital projects funds.

The Commonwealth also took other operational measures to achieve balance.

- ◆ 3,240 employees took advantage of an early-retirement program offered by the Commonwealth in the executive branch and higher education, saving the Commonwealth \$30.8 million in fiscal 2002 and \$165.8 million in FY03. Filling of vacancies in these positions amounted to \$1.4 million in fiscal 2002 and is expected to amount to \$29 million in fiscal 2003. Additional staff reduction measures, including layoffs, have commenced.
- ◆ A tax package estimated to increase tax revenues by \$1.1 billion in FY03 was enacted including increases in taxes on cigarettes and capital gains, the elimination of the personal income tax charitable deduction, and increases in personal income tax exemptions.
- ◆ In addition, the fiscal 2003 General Appropriations Act increased certain fees.

The Governor during fiscal 2002 used her gubernatorial powers as authorized in Massachusetts General Laws Chapter 29, Section 9C to reduce spending. This practice has continued in fiscal 2003.

Finally, the Treasurer – Receiver General refunded \$1.4 billion in older, higher interest debt to take advantage of historically low interest rates to save on current debt service.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the statutory basis of accounting and other supplementary information, in addition to the basic financial statements themselves.

Government – wide Financial Statements and how they relate to other perspectives

These new **government - wide financial statements** present the reader with a broad overview of the Commonwealth's finances in a manner similar to a private sector business. The statements include the *Statement of Net Assets*, which presents the assets, liabilities and net assets for the government as a whole, and the *Statement of Activities*, which presents the functional expenses, offsetting revenues and changes in net assets of the Commonwealth. Both of the statements have separate sections for three different types of Commonwealth programs or activities. These activities are *Governmental Activities*, *Business-Type Activities* and *Discretely Presented Component Units*.

The government – wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements and Major Component Unit Financial Statements

Funds are groups of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other governments, uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. Their financial statements focus on individual parts of the Commonwealth government, reporting its operations in more detail than the government – wide statements. All of the funds of the Commonwealth can be divided into three categories. It is important to realize that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are *Governmental Funds*, *Proprietary Funds* and *Fiduciary Funds*. Further discussion on the funds can be found in the section "Financial Analysis of the Commonwealth's Funds" and in Note 1 to the financial statements.

Component unit financial statements are presented for entities where the Commonwealth has financial accountability, but are independent of the core Commonwealth operations. They operate similar to private - sector businesses. Major component units are presented discretely along with minor component units in the aggregate.

Notes to the Financial Statements and Required Supplementary Information

The notes provide additional information that is essential to a full understanding of the financial statements as of the date provided in the government – wide and the fund financial statements. The notes to the financial statements can be found immediately following the component units' financial statements.

The required supplementary information section includes a budgetary comparison schedule, which contains a reconciliation comparing the original general appropriation act, all supplemental appropriations and actual budgetary spending. A variance column is also provided. The ending balance contained in this statement is the budgetary fund balance. The fund balance for the General Fund as presented in the governmental fund financial statements. Other supplementary information includes combining schedules for nonmajor governmental funds.

GOVERNMENT – WIDE FINANCIAL ANALYSIS

Net Assets

Major Long – Term Obligations for Assets of Political Subdivisions (amounts in millions)

Municipal school construction grants	\$	3,629
Bonds issued to fund the MBTA		625
Central Artery / Tunnel Project to be transferred to the Turnpike.....		9,311
Central Artery / Tunnel Project to be transferred to Massport.....		355
Change in Unrestricted Net Assets due to Items Unique to the Commonwealth.....	\$	<u>13,920</u>

Net assets may serve over time as a useful indicator of a government's financial position. The Commonwealth's combined net assets (governmental and business-type activities) showed a net deficit of nearly \$4.4 billion at the end of 2002. The *unrestricted net assets* are negative by \$15.5 billion. Of this \$15.5 billion, nearly \$14 billion is a result of three activities where the Commonwealth decided to fund assets that it does not own. Among other things, this was due to the aforementioned Commonwealth bonding for the Central Artery / Tunnel Project (project) capital costs. Pursuant to the Metropolitan Highway System legislation from 1997, the project will transfer primarily to the Massachusetts Turnpike Authority, a component unit of the Commonwealth, upon each segment's completion. In effect, the assets will largely be with the Turnpike Authority, while a large portion of the liabilities will remain with the Commonwealth. In addition, the Commonwealth funds a large portion of debt issued by cities and towns to construct or rehabilitate their schools. These obligations are part of the school construction grants program (known as school building assistance). These liabilities amount to approximately \$3.6 billion at June 30, 2002.

Exclusive of assets where the Commonwealth acts as a fiduciary, the Commonwealth's current cash and investments decreased by nearly \$1.7 billion between July 1, 2001 and June 30, 2002. This is directly due to the drop in tax revenue and continuation or rises in the Commonwealth's core expenses for debt service, Medicaid and direct local aid. The year was marked by a significant amount of commercial paper borrowing due to fiscal conditions to finance events such as the payment of local aid. Over \$1.8 billion was also drawn from longer – term reserves to pay for current expenses and nearly \$2.1 billion was expensed from the unemployment compensation fund due to the downturn in the economy.

Long – term assets increased by about \$2.3 billion. A total of \$20.7 billion of the Commonwealth's net assets reflect the Commonwealth's investment in traditional capital assets such as land, buildings, infrastructure and equipment, net of accumulated depreciation. GASB Statement 34 requires the addition of the value of investment in the Commonwealth's infrastructure, including roads, bridges, beaches, dams and other immovable assets for the first time to the face of the

Commonwealth's financial statements. As these assets provide services to citizens, they are not available to finance future spending unless they are sold. Although the Commonwealth's investment in its capital assets is also reported net of related debt, it must be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The bulk of the Commonwealth's net assets lie in its capital assets and long – term liabilities. Current assets and liabilities are amounts that are available in the current period and obligations that will be paid within one year, respectively. The Commonwealth's current assets were \$7.7 billion, while its current liabilities were nearly \$6.6 billion. Restricted net assets noted above represent resources that are subject to external constraints on resources. The tables below portray the Commonwealth's net assets and the changes to those net assets for the fiscal year.

Net Assets as of June 30, 2002
(in millions of dollars)

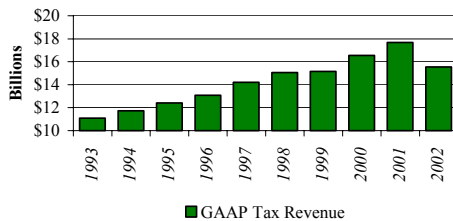
	June 30, 2002		
	<u>Governmental</u>	<u>Business-Type</u>	<u>Total Primary</u>
	<u>Activities</u>	<u>Activities</u>	<u>Government</u>
Current and other non-capital assets.....	\$ 7,424	\$ 3,012	\$ 10,436
Capital assets	<u>19,227</u>	<u>1,486</u>	<u>20,713</u>
Total Assets	<u>26,651</u>	<u>4,498</u>	<u>31,149</u>
Long-term liabilities	28,084	853	28,937
Other liabilities	<u>5,982</u>	<u>585</u>	<u>6,567</u>
Total Liabilities	<u>34,066</u>	<u>1,438</u>	<u>35,504</u>
Net assets:			
Invested in capital assets,			
net of related debt	5,611	1,032	6,643
Restricted	2,694	1,784	4,478
Unrestricted	<u>(15,721)</u>	<u>244</u>	<u>(15,477)</u>
Total Net Assets	<u>\$ (7,416)</u>	<u>\$ 3,060</u>	<u>\$ (4,356)</u>

Changes in Net Assets
(Amounts in millions)

Total net assets as of June 30, 2001	\$ (612)
Decrease in cash, investments, receivables and payables	(3,012)
Increase in capital assets, net of accumulated depreciation	2,367
Increase in outstanding long - term obligations	<u>(3,099)</u>
Total Net Assets, June 30, 2002	<u>\$ (4,356)</u>

Changes in Net Assets

Revenue from Taxation – GAAP Basis 1993-2002



The Commonwealth's net assets decreased by \$3.7 billion. This drop is directly due to dramatic declines in tax revenues while programmatic expenses remained largely unchanged, or in the case of health care related items, increased. From a fund perspective, Medicaid and Health and Human Services rose 9.5% combined or \$983 million from 2001. Approximately half of the Commonwealth's total revenue came from taxes, while the remainder resulted from programmatic revenues, including charges for services and grants and contributions, the bulk of which is federal aid. From a fund perspective, federal grants and reimbursements increased by over \$700 million this year, largely due to \$378 million being drawn in federal unemployment compensation grants and federal participation in the Medicaid program, coupled with large increases in operating grants and contributions activity at the Institutions of Higher Education. The largest drops in tax revenue were in income and corporate taxation, together amounting to nearly a \$2.3 billion decline. Sales taxation declined by \$47 million. Motor fuels and other taxation combined were down only \$9 million.

The Commonwealth's revenues are presented in the table and graphics that follow:

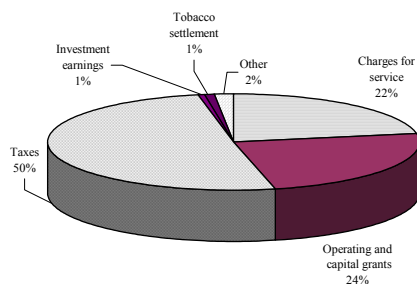
Changes in Net Assets as of June 30, 2002 (in millions of dollars except percentages)

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total Primary Government</u>	<u>Percentage of Primary Government</u>
Revenues				
Program Revenues	\$ 13,552	\$ 1,824	\$ 15,377	50%
General revenues				
Taxes	14,689	850	15,539	50%
Other	-	115	115	0%
Total Revenues	28,241	2,789	31,031	100%
Expenses				
Medicaid	5,979	-	5,979	17%
Direct local aid	5,253	-	5,253	15%
Health and human services	4,196	-	4,196	12%
Lottery	3,454	-	3,454	10%
Higher education	-	2,365	2,365	7%
Primary and secondary education	1,836	-	1,836	5%
Unemployment compensation	-	2,183	2,183	6%
Other	9,509	-	9,509	27%
Total Expenses	30,227	4,548	34,775	100%
Excess (deficiency) before transfers	(1,986)	(1,759)	(3,744)	
Transfers	(1,019)	1,019	-	
Increase (decrease) in net assets	(3,005)	(740)	(3,744)	
Net assets - beginning - restated	(4,411)	3,799	(612)	
Net assets - ending	\$ (7,416)	\$ 3,059	\$ (4,356)	

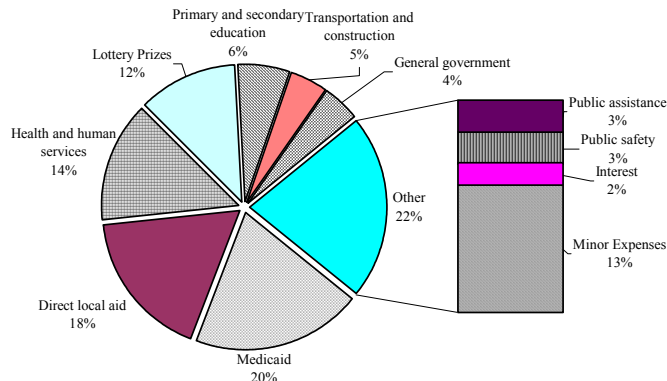
Of tax revenues received, the largest category is income taxes. Of the \$14.7 billion in tax revenue within governmental activities, \$8.3 billion was from income taxation, \$3.7 billion from sales, \$584 million from corporations, \$666 million from motor fuels and \$1.5 billion from other forms of taxation. The largest operating grants are the federal Medicaid subsidies. The largest capital grants are for transportation, including federal grants for the Central Artery / Tunnel project. Finally, Lottery revenues encompass approximately 2/3 of the charges for services.

20% of all the Commonwealth's governmental expenses are for Medicaid. However, it must be noted that over half of the Medicaid expenses are subsidized in the form of federal grants. These subsidies are noted below in the "charges for services" segment. The largest expense that is not subsidized by program revenues is direct local aid to the municipalities of the Commonwealth. According to the Department of Revenue, Division of Local Services, nearly 70% of these funds are earmarked for public education or related activities. Below is a chart that details some of the larger governmental expenses of the Commonwealth.

Revenue – Governmental Activities
Fiscal Year Ending June 30, 2002

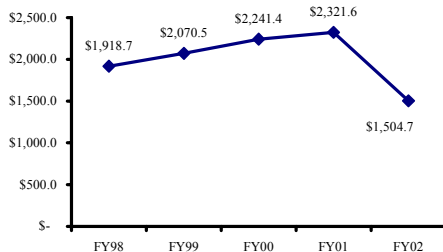


Major Expenses – Governmental Activities
Fiscal Year Ending June 30, 2002



Business – Type Activities

Unemployment Compensation Fund
Net Assets
Fiscal Year Ending June 30, 2002
(Amounts in Millions)



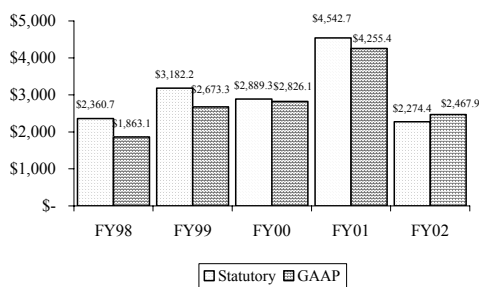
Business – type activities are functions that equate to activities of a private enterprise. In the Commonwealth under Statement 34, the institutions of higher education were judged to be such entities because of their lack of separate taxation. Also, Statement 34 requires unemployment compensation to be portrayed as a business – type activity.

The business - type activities decreased the Commonwealth's net assets by over \$739 million. This resulted from primarily an \$817 million decrease in the Commonwealth's Unemployment Compensation Fund due to the large increase in the number of unemployed workers during the year. This decline was offset by a \$78 million increase in the net assets of the schools of higher education, largely due to increases in net tuition and fee revenue (by nearly 25%) and in federal grants and reimbursements (by over 115%). The Unemployment Compensation Fund activity will be a significant indicator of the fiscal health of the business – type activities of the Commonwealth during any continued economic downturn.

FINANCIAL ANALYSIS OF THE COMMONWEALTH'S FUNDS

Governmental Funds

**Governmental Fund Balance
Statutory vs. GAAP**
(Amounts in Millions)



As noted earlier, the Commonwealth uses fund accounting to ensure and demonstrate interperiod equity and the extent to which current resources are financing the full cost of services that citizens are receiving.

Governmental funds account for the near term inflows, outflows and balances of spendable resources of the Commonwealth's core functions and services. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balances. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

The Commonwealth develops its budgets on a statutory basis. A comprehensive process is conducted with all departments to convert the statutory basis reporting to generally accepted accounting principles. System generated reports from the state accounting system and data warehouses are combined with reports from each of the Commonwealth departments to record governmental fund perspective, departmental accruals. There are four major items which account for almost all the difference between the statutory basis reporting and the governmental fund perspective: accruals for the Medicaid program, compensated absences, claims and judgments and tax revenue accruals. From the governmental fund perspective, additional major adjustments are necessary to present the government wide statements, largely for debt and fixed assets activity.

Governmental Fund Operations - GAAP Basis - Fund Perspective
(Amounts in millions)

	FY98	FY99	FY00	FY01	FY02
Beginning fund balances	\$ 1,030.6	\$ 1,863.1	\$ 2,673.3	\$ 2,826.1	\$ 4,255.4
Restatement due to implementation of GASB 34	-	-	-	-	551.2
Revenues and other financing sources	31,249.3	33,272.7	38,174.4	39,256.4	36,476.6
Expenditures and other financing sources	30,416.8	32,462.5	38,021.6	37,827.1	38,815.3
Excess / (deficiency)	832.5	810.2	152.8	1,429.3	(1,787.5)
Ending fund balances	<u>\$ 1,863.1</u>	<u>\$ 2,673.3</u>	<u>\$ 2,826.1</u>	<u>\$ 4,255.4</u>	<u>\$ 2,467.9</u>

As of the end of fiscal 2002, the Commonwealth's governmental funds reported combined ending fund balances of \$2.5 billion, a decrease of \$1.8 billion from the previous year. However, of the \$2.5 billion, the following amounts are reserved or committed:

Governmental Funds - Reserves of Fund Balances
(Amounts in millions)

	2002	2001	Change	Percentage Change
Continuing appropriations	\$ 168.0	\$ 290.0	\$ (122.0)	-42%
Tax Reduction	-	33.6	(33.6)	-100%
Commonwealth stabilization	881.8	1,715.0	(833.2)	-49%
Retirement of indebtedness	350.8	109.3	241.5	221%
Capital projects	1,053.8	1,772.8	(719.0)	-41%
Central artery				
Workers Compensation	239.9	147.2	92.7	63%
Unreserved	(226.4)	187.5	(413.9)	-221%
Total Fund Balances	\$ 2,467.9	\$ 4,255.4	\$ (1,787.5)	

The tax reduction fund balance was transferred to the general fund as part of the measures taken to balance the budget. Over \$1 billion was used from the stabilization fund to balance the budget. The amounts reserved for capital projects represent projects that are in process, but have been bonded for in advance. As project costs are expended, the reserve will decrease. The bulk of these funds relate to the Central Artery / Tunnel project. The reserve for central artery workers' compensation and general liability represents the balance of funds earmarked for claims in an owner controlled insurance program. The reserve will continue to decline as claims arise during the windup of the project. The remaining \$226 million of the governmental fund balance is an unreserved and undesignated deficit.

The general, highway and local aid funds are the chief operating funds of the Commonwealth. At the end of the current fiscal year, the fund balance of the general fund was over \$2.4 billion. Of this amount, over \$881 million was set aside administratively in the aforementioned Commonwealth's Stabilization fund. The remaining \$1.4 billion is unreserved. However, this balance offsets a combined deficit of an equal amount in the highway and local aid funds. The administration and the Legislature have taken a balanced approach using \$867 million from the Stabilization and Tax reduction reserves combined with necessary reductions in service levels throughout the Commonwealth. Another \$86 million was also reserved for continuing appropriations to liquidate contracts and purchase orders from the prior fiscal year in the general fund.

The fund balance of the general fund dropped by nearly \$355 million during fiscal 2002. This is largely due to lower tax revenues with increasing expenditures.

Proprietary Funds

Proprietary Funds report activities of the Commonwealth that are structured similar to businesses. Proprietary funds provide the same type of information as the government – wide financial statements, only in more detail.

As discussed in the business – type activities above, the business type activities decreased the Commonwealth's net assets by over \$739 million.

BUDGETARY HIGHLIGHTS

Differences between the original and final budget expenditures amount to over \$400 million. The supplemental budgets are summarized as follows:

- ◆ Increases in Medicaid spending by nearly \$300 million.
- ◆ Increases to Health and Human Services functions by \$162 million.
- ◆ Supplemental budgets to give incentives for early retirement.
- ◆ A final supplemental budget with acts necessary to close the fiscal year in balance.

Both the Medicaid and the remaining Health and Human Service functions increased as a result of prescription drug price increases.

The original budget was delayed for fiscal 2002 due to the aforementioned decline in tax revenues. After the passage of the budget in December 2001, several supplemental budgets were needed to address the costs of government, specifically Health and Human services functions. Of the \$300 million increase in these expenditures between the original and final budgets, almost all of this additional spending is in relation to the Medicaid program. Details of these changes are found in the required supplementary information following the footnotes to the financial statements.

The aforementioned draws on reserves could hamper the ability to provide services in the future at current levels without significant changes to revenue streams or expenditure structures.

**CAPITAL ASSET AND DEBT
ADMINISTRATION**
Capital Assets

The Commonwealth's investment in capital assets for its governmental and business-type activities as of June 30, 2002, amounts to \$28.7 billion, net of accumulated depreciation of \$8.0 billion, leaving a net book value of \$20.7 billion. With the implementation of GASB Statements 34, 35, 37 and 38 as of July 1, 2001 (fiscal 2002), infrastructure assets are now reported on the Commonwealth's statement of net assets. Infrastructure includes assets that are normally immovable and of value only to the Commonwealth, such as roads, bridges, beaches, piers and dams. Of the investment in capital assets noted above though, \$9.7 billion of this amount includes assets that will transfer to the Turnpike Authority and the Massachusetts Port Authority upon completion of the Central Artery / Tunnel project. An additional \$2 billion has already been transferred to these Authorities of completed portions of the project. Capital assets of the Commonwealth include land, buildings, improvements, equipment, vehicles and infrastructure.

Including the implementation of infrastructure, the total increase in the Commonwealth's investment in capital assets from 2001 to 2002 was nearly \$16.1 billion, net of disposals and changes in accumulated depreciation. An additional \$912.2 million, net, was transferred from construction in process to fixed assets. Additional information on the Commonwealth's capital assets can be found in the notes to the financial statements.

Continued

The following table details the capital asset activity for the Commonwealth:

Changes in Capital Assets
(net of depreciation - amounts in thousands)

	Governmental Activities		Business - type Activities		Total	
	2002	2001	2002	2001	2002	2001
Land	\$ 643,917	\$ 595,295	\$ 68,185	\$ 63,814	\$ 712,102	\$ 659,109
Historical treasures	-	-	553	536	553	536
Construction in process	465,797	30,478	115,740	130,423	581,537	160,901
Construction in process - Central Artery / Tunnel Project	9,666,140	8,293,818	-	-	9,666,140	8,293,818
Buildings	1,326,480	648,038	922,153	788,395	2,248,633	1,436,433
Machinery and equipment	146,895	152,041	265,030	209,782	411,925	361,823
Infrastructure	6,977,621	7,318,142	-	-	6,977,621	7,318,142
Library collections	-	-	114,679	115,410	114,679	115,410
Total	\$ 19,226,850	\$ 17,037,812	\$ 1,486,340	\$ 1,308,360	\$ 20,713,190	\$ 18,346,172

Debt Administration

The Commonwealth issues short-term and long-term debt that is primarily of a general obligation nature. Debt that is general obligation in nature is backed by the full faith and credit of the Commonwealth and paid from governmental funds. The Commonwealth's outstanding governmental debt increased by nearly \$956 million, net of refunding issues, in fiscal 2002, largely for bonds issued related to the Central Artery / Tunnel project. In summary, nearly \$2.9 billion in general, special obligation and refunding debt was issued. For governmental purposes, the \$2.9 billion includes:

- ◆ Nearly \$1.4 billion in refunding bonds were issued including special obligation bonds issued in a "cross - over" refunding. The escrow funded by the refunding bonds and related premium secures the principal related to \$190 million of previously issued special obligation bonds, exclusive of call premiums, which will mature during fiscal 2003, 2004, 2006 and 2008. As these bonds are not defeased, a liability exists for the undefeased debt.
- ◆ Nearly \$1.5 billion in new general and special obligation debt was issued, taking advantage of some of the lowest interest rates in history.
- ◆ Over \$692 million in bond principal was repaid.

Additional information on the Commonwealth's short and long-term debt obligations can be found in the notes to the financial statements of this report.

Below is a table, which details the Commonwealth's debt activity for the fiscal year:

Changes in Long - Term Debt Obligations
(net of related premiums and discounts - amounts in thousands)

	<u>Governmental</u> <u>Activities</u>		<u>Business - type</u> <u>Activities</u>		<u>Total</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
General obligation bonds	\$ 12,691,884	\$ 11,957,934	\$ -	\$ -	\$ 12,691,884	\$ 11,957,934
Special obligation bonds	763,926	542,195	-	-	763,926	542,195
Revenue obligation bonds	-	-	670,430	575,148	670,430	575,148
Grant anticipation notes	1,499,325	1,499,325	-	-	1,499,325	1,499,325
Total	\$ 14,955,135	\$ 13,999,454	\$ 670,430	\$ 575,148	\$ 15,625,565	\$ 14,574,602

**ECONOMIC FACTORS AND NEXT
YEAR'S BUDGETS AND RATES**

Massachusetts and the rest of the nation are in the midst of a profound economic downturn. Even though our Commonwealth is home to many world-renowned institutions of medicine and higher education, both public and private, keeping the economy relatively stable and full of ingenuity, no sector is immune from this current recession.

The Commonwealth, with an international reputation for medical, cultural, historical, and educational institutions, remains the economic and educational hub of New England. The Commonwealth's economy remains diversified but its strongest component is its knowledge-based technology and service industries.

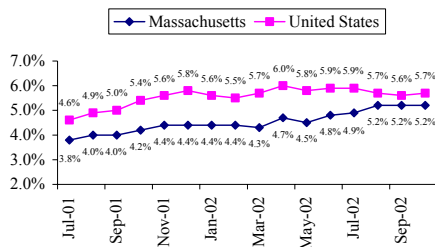
Massachusetts' infrastructure provides strong support for this knowledge-based economy. There are over 120 colleges and universities located in Massachusetts, and the 2000 US Census has estimated that 35% of the residents over age 25 have earned bachelor's degrees, compared to an estimate of 25.1% for the United States as a whole. Our capital, Boston, has over 20 hospitals and three medical schools.

Inflation continues to largely be in check. The Boston consumer price index though has risen 1.9% from July 2001 to July 2002, as opposed to only 1.5% for the rest of the country.

As of October 2002, the unemployment rate in the Commonwealth stood at 5.2%. However, since fiscal 2000, the rate has dramatically risen. The Commonwealth, though, is still well below the national rate of 5.7%.

Due to the recession, tax revenues have dropped sharply in the Commonwealth. The largest drops have come from income taxes, which were down 18% from the previous year.

*Monthly Unemployment Rate
July 2001 – October 2002*



REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Commonwealth of Massachusetts, Office of the State Comptroller, 1 Ashburton Place, 9th Floor, Boston, Massachusetts, 02108. You may also download this report at: <http://www.mass.gov/osc/reports/reports.htm>.